United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ARGUMENT

Signed

75-4248

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

ESTATE OF AMY ANN McGINNIS SPALDING,
Deceased, CHARLES F. SPALDING,
Executor,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee

ON APPEAL FROM THE DECISION OF THE

UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

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No. 75-4248

ESTATE OF AMY ANN McGINNIS SPALDING, Deceased, CHARLES F. SPALDING, Executor,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee

ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

STATEMENT OF THE ISSUE PRESENTED

Whether the Tax Court correctly decided that Charles F. Spalding was not the "surviving spouse" of Amy Ann McGinnis Spalding, within the meaning of Section 2056(a) of the Internal Revenue Code of 1954, where a Nevada divorce from his wife, Elizabeth, had been held invalid by a New York Court, with the consequence that Amy's estate was not entitled to an estate tax marital deduction for property passing to him.

STATEMENT OF THE CASE

This appeal involves a deficiency in estate taxes. (R. 23a.)[1/] The memorandum opinion of the Tax Court in favor of the

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1/ "R." references are to the separately bound joint appendix.

Commissioner, filed July 30, 1975, is reported at 34 T.C.M. 1074. (R. 22a-30a.) Decision in the Commissioner's favor in the sum of $415,121.45 was entered on October 2, 1975. (R. 31a.) The taxpayer filed a timely notice of appeal on November 10, 1975. (R. 2a.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

The facts of this case, which were fully stipulated (R. 3a-6a), are, as found by the Tax Court (R. 23a-27a), as follows:

Charles Spalding, the taxpayer in the instant proceeding, is the duly qualified and acting executor of the estate of Amy Ann McGinnis Spalding, having been appointed by the Superior Court of California for the County of San Mateo on January 9, 1970. Charles and Elizabeth C. Spalding (Elizabeth) were married on May 4, 1945, in Haverford, Pennsylvania. They resided in Connecticut until November, 1962, when Charles moved to Westchester County, New York, Elizabeth choosing to remain a resident of Connecticut. Charles, on March 19, 1964, obtained a decree of divorce in the Second Judicial District Court of the County of Washoe, in the State of Nevada, he having personally appeared while she failed to appear, although she was personally served in Vermont. (R. 23a-24a.)

Subsequently, Elizabeth brought an action for a declaratory judgment in the Supreme Court of the State of New York, County of Westchester, in which she sought to establish that she remained

Charles' legal wife. In that action, in which both parties appeared, the court entered findings of fact and conclusions of law and judgment which stated (R. 25a-26a):

> FINDINGS OF FACT
>
> *   *   *   *   *
>
> 4. That the defendant [Charles] since November, 1962, through June 1965, was a domicilliary [sic] of the County of Westchester and State of New York.
>
> *   *   *   *   *
>
> CONCLUSIONS OF LAW
>
> 1. The judgment of divorce obtained by the defendant, Charles F. Spalding, against the plaintiff in the State of Nevada on or about the 19th day of March, 1964, is null and void on the ground that the Second Judicial District Court of the State of Nevada, in and for the County of Washoe, had no jurisdiction of either the defendant, Charles F. Spalding nor of the plaintiff, Elizabeth C. Spalding herein, the plaintiff having been domiciled in the State of Connecticut at the time, and the defendant, Charles F. Spalding, having been domiciled in the State of New York.
>
> 2. That the marriage between the defendant, Charles F. Spalding and the plaintiff, Elizabeth C. Spalding herein, was not legally dissolved by a Court of competent jurisdiction.
>
> JUDGMENT
>
> Now, * * * it is
>
> ORDERED, ADJUDGED AND DECLARED, that the alleged divorce procured by the defendant, Charles F. Spalding, from the plaintiff, in the Second Judicial District Court in the County of Washoe in the State of Nevada on the 19th day of March, 1964, was and is null and void, and of no effect whatsoever, and it is further

> ORDERED, ADJUDGED AND DECLARED, that the plaintiff, Elizabeth C. Spalding, is and at all times since May 4, 1945, has been the lawful wife of the defendant, Charles F. Spalding.

Neither party appealed from either the Nevada or the New York court ruling. (R. 26a.)

On May 11, 1968, Charles participated in a marriage ceremony with Amy in San Francisco, California. Amy died testate on December 18, 1969, at which time she and Charles resided in Hillsborough, California. In her will, which was probated on January 8, 1970, by the Superior Court of the State of California for the County of San Mateo, Amy devised her interest in their residence, and bequeathed several articles of property and a portion of her residuary estate to Charles pursuant to a marital deduction formula provision. (R. 26a.)

Amy's executor filed a timely federal estate tax return claiming a marital deduction of $1,130,803.55. (R. 27a.) The Commissioner disallowed the entire deduction on the grounds that Amy and Charles were not legally and validly married on the date of her death, and thus Charles was not Amy's "surviving spouse", within the meaning of Section 2056(a) of the 1954 Internal Revenue Code. The Tax Court, relying upon its prior unanimous reviewed decisions in Estate of Steffke v. Commissioner, 64 T.C. 530 (1975), and Estate of Goldwater v. Commissioner, 64 T.C. 540 (1975), ruled that "where a prior divorce had been held to be invalid by a court of the state where the decedent's estate

was being administered, the 'surviving spouse' requirement of section 2056(a) was not satisfied." The taxpayer appeals from that determination.

SUMMARY OF ARGUMENT

The legal issue in this case concerns the right of an estate to take a marital deduction, under Section 2056 of the Internal Revenue Code of 1954, for amounts bequeathed to a man by his putative spouse, where the recipient's wife has obtained a New York decree, unopposed by the recipient, that the recipient's divorce was invalid and void. Section 2056 of the Code allows a marital deduction of up to fifty percent of the value of the decedent's estate, but only for amounts passing to the decedent's "surviving spouse". This provision was added in 1948 to put common law jurisdictions on a par with community property states, which had always allowed validly married spouses to attribute fifty percent of the property accumulated during marriage to be attributed to each. As the legislative history shows, this estate-splitting tax benefit was made available only to the estates of individuals who, at the time of death, were validly married to the recipients, the bequests to whom were to be subject to the estate tax marital deduction. Since, in this case, the courts of the State of California, the domicile of the decedent at her death, would have been obliged by Article IV, Section 1 of the United States Constitution to recognize the New York court declaration that her beneficiary was still legally

married to his first wife, Charles, the beneficiary, was clearly not the decedent's "surviving spouse".

The estate, on appeal, does not in fact contend that the decedent and Charles were legally married at her death, but instead contends that this Court's prior opinions in Borax' Estate v. Commissioner, 349 F. 2d 666 (C.A. 2, 1965), cert. denied, 383 U.S. 935 (1966), and Wondsel v. Commissioner, 350 F. 2d 339 (C.A. 2, 1965), cert. denied, 383 U.S. 935 (1966), require the conclusion that the remarriage was valid, for estate tax purposes, and that consequently Charles was the decedent's surviving spouse, and bequests to him qualified for the marital deduction allowance. These cases, however, are distinguishable. In Borax' Estate and Wondsel, this Court, in an income tax setting, applied a "rule of validity" to a remarriage which was followed by a judicial declaration of the invalidity of one of the spouses' prior divorces, with the consequence that payments by the husband to the first wife under a separation agreement were found to be "incident to * * *[a] divorce", within the meaning of Section 71 of the 1954 Internal Revenue Code (26 U.S.C.), and therefore deductible by the husband. Secondly, this Court in Borax' Estate and Wondsel felt obliged to rule that because of its holding that the divorce was valid, the subsequent marriage was also valid, for income tax purposes, so that the man and woman were "husband and wife", and entitled to file joint income tax returns, and claim dependency exemptions. This case, however, involves an estate tax question, under circumstances where the

legislative history authoritatively announces that, before an estate tax marital deduction can be obtained, a valid marriage at the time of the decedent's death must be established. Since Section 2056 contemplates that there be a valid marriage at the decedent's death before bequests to a "surviving spouse" can qualify for the marital deduction, this Court's prior rulings in Borax' Estate and Wondsel can have no application. Examination of this Court's legal analysis in Borax' Estate and Wondsel supports this distinction, for this Court in those cases concentrated on the income tax objectives apparent in the alimony statute to allow individuals separated as well as divorced to make their own income-splitting arrangements. In addition, this Court's subsequent affirmation of the remarriage and conclusion that the subsequent marital partners were "husband and wife", so as to be entitled to file joint income tax returns and claim dependency exemptions, was based primarily on its initial determination that, for income tax purposes, the divorce was valid, rather than upon any extensive analysis of the provisions of the Code authorizing the filing of joint income tax returns, or the claiming of dependency exemptions. The strong legislative history of the estate tax provision in question, as well as the very language of the statute itself, mandate a conclusion that a donor must be validly married to the donee at his death for the marital deduction allowance to be applicable.

In any event, extension of this Court's rulings in Borax' Estate and Wondsel to validate a marriage which has been

judicially determined to be invalid, for failure to terminate a prior marriage, would produce anomalies and result in application of the marital deduction provisions which may, in particular circumstances, be detrimental to the estate. Thus, as in Estate of Steffke v. Commissioner, 64 T.C. 530 (1975), on appeal (C.A. 7, No. 75-2161), individuals who were married, for estate tax purposes, would be found, for state inheritance tax purposes, not to be validly married. Or, as in Estate of Goldwater v. Commissioner, 64 T.C. 540 (1975), on appeal (C.A. 2, No. 75-4277), where the first wife was successful in exercising her right of election against the estate, as the decedent's surviving spouse, the estate could attempt to claim a marital deduction as to amounts passing to both spouses. Finally, the protections afforded by state law to spouses who have been the subject of invalid divorces, including state interpretations of homestead exemption laws, the intestacy laws, rights to dower, etcetera, may be substantial enough in a given situation that granting the marital deduction to bequests to the putative spouse, which bequests are, of course, subject to the prior claims enumerated above, would result in a lesser marital deduction.

The rule announced by the Commissioner in Rev. Rul. 67-442, 1967-2 Cum. Bull. 65, that generally the law of the decedent's domicile towards the validity of the marriage will prevail, is a sound and expedient application of the statute and fully consonant with Section 2056's intent, and should be accepted by this Court.

ARGUMENT

THE TAX COURT CORRECTLY RULED THAT THE ESTATE WAS NOT ENTITLED TO THE MARITAL DEDUCTION SINCE CHARLES, THE DISTRIBUTEE, WAS NOT THE SURVIVING SPOUSE OF AMY, THE DECEDENT

A. The marital deduction was enacted to equalize the estate tax between common law and community property states, both property concepts depending on valid marriages

The legal issue raised on this appeal is whether Charles F. Spalding was Amy Ann McGinnis Spalding's "surviving spouse", within the meaning of Section 2056(a) of the Internal Revenue Code of 1954, Appendix, *infra*.[2/] Section 2056(a) of the Code provides generally that, in computing the taxable estate of a decedent for estate tax purposes--

> * * * the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate. (Emphasis supplied.)

While resolution of this question affects only the right of Amy's estate to claim an estate tax deduction for amounts which she bequeathed to Charles, this Court's interpretation of the phrase "surviving spouse" could arguably have an effect in other areas of the estate and gift tax laws, particularly in the area

2/ Estate of Goldwater v. Commissioner, 64 T.C. 540 (1975), on appeal C.A. 2, No. 75-4277, and Estate of Steffke v. Commissioner, 64 T.C. 530 (1975), on appeal (C.A. 7, No. 75-2161), raise similar legal questions regarding the meaning of "surviving spouse".

of the gift tax marital deduction authorized by Section 2523 of the 1954 Internal Revenue Code[3/] (26 U.S.C.), the gift-splitting provisions authorized by Section 2513(a)(1) of the Code[4/] (26 U.S.C.), and the provision in Section 2515(a) of the Code (26 U.S.C.) which excludes from the gift tax provisions "The creation of a tenancy by the entirety in real property, either by one spouse alone or by both spouses."[5/]

The facts of this case are undisputed. Until 1964 Charles was married to Elizabeth C. Spalding. In that year Charles, who had been a resident of the State of New York since moving out of

3/ Section 2523 of the 1954 Internal Revenue Code provides for a gift tax marital deduction of one half of the value of all gifts of "property to a donee who at the time of the gift is the donor's spouse".

4/ Section 2513(a)(1) of the Code provides that:

> A gift made by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. * * * For purposes of this section, an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

5/ Section 2515 of the Code states:

> The creation of a tenancy by the entirety in real property, either by one spouse alone or by both spouses, and additions to the value thereof in the form of improvements, reductions in the indebtedness thereon, or otherwise, shall not be deemed transfers of property for purposes of this chapter, regardless of the proportion of the consideration furnished by each spouse, unless the donor elects to have such creation of a tenancy by the entirety treated as a transfer, as provided in subsection (c).

the family residence in Connecticut in 1962, obtained a Nevada divorce, Charles personally appearing and having Elizabeth personally served in Vermont. In 1967, Elizabeth brought an action for a declaratory judgment in the New York courts seeking a declaration that she remained Charles' legal wife. In that action, in which both Charles and Elizabeth personally appeared, the New York court in March, 1968, found Elizabeth to be Charles' "lawful wife" because, since Charles was a domiciliary of the State of New York through June, 1965,[6/] the Nevada divorce decree was null and void for lack of jurisdiction on the Nevada court's part of either Charles or Elizabeth. Although neither Charles nor Elizabeth ever appealed from the New York and Nevada decisions, Charles participated in a marriage ceremony with Amy Ann McGinnis in California on May 11, 1968. After Amy's death on December 18, 1969, Charles, her executor, attempted to claim a marital deduction for property bequeathed to him in Amy's will. The issue in this case concerns the propriety of the Tax Court's conclusion, based upon the rationale expressed in the unanimous reviewed decisions of Estate of Steffke v. Commissioner, supra, and Estate of Goldwater v. Commissioner, supra, that the New York court's declaration of the viability of Charles' marriage to Elizabeth prohibited a finding that Charles was Amy's "surviving spouse".

6/ Charles testified that he was a resident of the State of New York from November, 1962 until the end of May, 1965. (Jt. Ex. 6-F, Sept. 28, 1967, Tr. 7.)

B. A valid existing marriage is required for a marital deduction

As the Tax Court in the Steffke and Goldwater cases noted, the marital deduction provision now found in Section 2056 of the Code was first enacted as part of the Revenue Act of 1948, c. 168, 62 Stat. 110, 117. It was added, as was Section 1001 of the Internal Revenue Code of 1939, as amended, the predecessor of Section 2513 of the 1954 Code (division of gifts between spouses for the gift tax) to put residents of community-property states and of common-law states on an equal footing, where transfers of property from one spouse to another were concerned. See H. Rep. No. 1274, 80th Cong., 2d Sess., pp. 3-26 (1948-1 Cum. Bull. 241, 242-261), Appendix, infra; S. Rep. No. 1013, 80th Cong., 2d Sess., pp. 3-27 (1948-1 Cum. Bull. 285, 288-305), Appendix, infra. This legislative purpose, which is fully explicated in United States v. Stapf, 375 U.S. 118, 128 (1963), was to provide complete geographical equalization as to taxation of transfers between spouses during the lifetime of spouses, or at the death of one of the spouses, and to settle the tax inequalities on such transfers which had continued to exist after the enactment of amelioratory legislation in 1942. To remedy the tax inequality which had existed prior to 1942 between residents of community-property states and common-law jurisdictions, under which the laws of community-property states had determined that only one half of community property belonged to each spouse, with the result that only one half of the value of community property belonged to the decedent spouse for estate tax purposes, while residents of

common-law states were required to include the full value of property owned jointly by both spouses, Section 402 of the Revenue Act of 1942, c. 619, 56 Stat. 798, amended Section 811(c) of the Internal Revenue Code of 1939 to provide, generally, that the entire value of community property should be included in the estate of the first spouse to die. See Fernandez v. Wiener, 326 U.S. 340, 358 (1945), upholding the constitutionality of this provision, as an excise tax "upon the surrender of old incidents of property by the decedent and the acquisition of new by the survivor". This solution, however, failed to remedy the problem, as situations continued to exist where transfers in both community property and common-law states continued to be taxed more heavily than similar transfers in the other jurisdictions. See the examples given in H. Rep. No. 1274, supra, pp. 24-26 (1948-1 Cum. Bull., pp. 260-261). The solution which the Congress reached was to repeal the 1942 enactment and to apply the "splitting technique" concurrently being applied to the income of residents of all jurisdictions, whereby the combined income of the husband and wife was to be attributed fifty percent to each, by allowing husband and wife to file joint income tax returns. This was done to avoid the income tax benefit which had theretofore been available to residents of community-property states, since under the law of community-property states, the earned income of one spouse was deemed to be earned, to the extent of one half, by the other.

H. Rep. No. 1274, supra, p. 26 (1948-1 Cum. Bull., p. 261).

As the House Report states (Ibid.)[7/]:

> In the case of the estate tax, "splitting" means an exemption in common-law States of up to one-half of the decedent's estate if it passes outright to the surviving spouse. No such exemption is needed for community property, since, in the absence of the 1942 amendments, the decedent will be taxable on only one-half the community assets. However, the exemption will apply in community-property States to separate property of the decedent which passes to his surviving spouse.

And, as finally reported out by the Senate Finance Committee, it was this "splitting technique" which was finally adopted by the Congress. S. Rep. No. 1013 (Part 2), 80th Cong., 2d Sess., p. 2 (1948-1 Cum. Bull. 285, 332):

> In general, under this new subsection a deduction is allowed for an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse but the aggregate amount of such deductions is limited to 50 percent of the value of the adjusted gross estate.

_/ The "splitting" analogy was also applied to gifts of property between spouses, as well as gifts from one spouse to a third party. H. Rep. No. 1274, supra, p. 26 (1948-1 Cum. Bull., p. 261):

> This "splitting" technique is also applied under the gift tax. In the case of gifts between spouses (other than the donor's interest in community property) this technique requires that only one-half the value of the gift be taxed since under the "splitting" technique the donee spouse in effect already owned one-half of the property. When a gift is made to someone other than a spouse, the husband and wife may elect to have the gift treated as though each had made one-half of the gift.

This report goes on, however, to state that "There are * * * certain important qualifications and limitations" (Ibid.) to the allowability of the estate tax marital deduction. Generally, these qualifications emphasize the pre-conditions which must exist, even today, before allowance of a marital deduction is justified: i.e.; (1) the decedent must own an "interest" in "property"; (2) which is includible in the decedent's estate, for estate tax purposes; and (3) which "passes" absolutely from the decedent to "his surviving spouse'. Each of the terms placed in quotations above received extensive analysis in Senate Report No. 1013 (Part 2). In particular, the Senate Report's discussion of the requirement that there be a "surviving spouse" to whom the property could pass, is direct and in point. In discussing the term "surviving spouse", the Senate Report states (S. Rep. No. 1013 (Part 2), pp. 6-7 (1948-1 Cum. Bull., p. 335):

> The status of an individual as the decedent's surviving spouse is determined at the time of the decedent's death. A legal separation which has not (at the time of the decedent's death) terminated the marriage does not affect such status for the purposes of section 812(e)(1). A transfer by the decedent during his lifetime to an individual to whom he was not married at the time of the transfer but to whom he is married at the time of his death and who survives him is a transfer by the decedent to his surviving spouse. If an interest in property passes from the decedent to a person who was his spouse but is not married to him at the time of his death, the interest is not considered as passing to the decedent's surviving spouse even though such person survives the decedent.

Several things become apparent, then, from a reading of this legislative history. First, the Congress clearly contemplated that an evaluation of the decedent's marital state should be made as of the decedent's death, and at no earlier time. Thus, as the legislative history declares, transfers of property to one not one's "spouse" at the time of the transfer could become eligible for the estate tax marital deduction, provided only that such person was "married [to the decedent] at the time of his death and * * * survives him". Or, to take the opposite situation, a transfer of property to one who, at the time of the transfer, was one's spouse, would not qualify for the marital deduction if such person was "not married to him at the time of his death". (Ibid.) Second, from the above discussion, it is quite clear that Congress contemplated that there should, in any event, be allowed only one marital deduction per estate--that, given the anti-polygamy laws of the country, only transfers of property to "decedent's surviving spouse", in the singular, were to be subject to the marital deduction.

C. Borax' Estate and Wondsel do not require a reversal of the Tax Court's conclusion that Charles is not Amy's "surviving spouse" for the estate tax marital deduction

The Tax Court, on these facts, held that the State of California, Amy's domicile at her death, would have been required under the Full Faith and Credit Clause of the Constitution (Constitution of the United States, Art. IV, Sec. 1) to recognize the validity of the New York judgment which, with jurisdiction over both parties, had declared the prior Nevada divorce invalid,

for failure to establish domiciliary jurisdiction over either Charles or Elizabeth. See Sutton v. Leib, 342 U.S. 402, 406-409 (1952); Crouch v. Crouch, 28 Cal. 2d 243, 169 P. 2d 897 (Sup. Ct. en banc, 1946); cf. Civil Code, West's Ann. Calif. Codes, §4401, holding that a subsequent marriage during the life of a former wife is illegal and void unless the former marriage has been dissolved. Then, finding the issue of whether an individual is a "surviving spouse" within the meaning of Section 2056 of the Code to be "not 'squarely in point'" with the prior decisions of this Court in Borax' Estate v. Commissioner, 349 F. 2d 666 (C.A. 2, 1965), cert. denied, 383 U.S. 935 (1966), and Wondsel v. Commissioner, 350 F. 2d 339 (C.A. 2, 1965), cert. denied, 383 U.S. 935 (1966), it concluded that Elizabeth remained Charles' wife. It logically followed that Charles could not have been Amy's "surviving spouse" when she died. (R. 29a-30a.)

On appeal, the taxpayer makes no contention that in fact he was Amy's surviving spouse,[8/] but instead urges that, under the principles announced by this Court in Borax' Estate and Wondsel,

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8/ Since Charles, in the New York action, deposed that he was a resident of the State of New York from November, 1962 through May, 1965, it is extremely unlikely that even the State of Nevada would continue to uphold the integrity of its prior decision granting Charles a divorce, since at the time of the divorce petition--February 27, 1964 (R. 20a)--Charles had failed to comply with a jurisdictional prerequisite of Nevada law that required Charles to "have been a resident of the state for a period of not less than six weeks preceding the commencement of the action." Nev. Rev. Stat. § 125.020(2). See Colby v. Colby, 78 Nev. 150, 369 P. 2d 1019 (1962), holding that a decree of divorce may be vacated where extrinsic fraud is demonstrated.

the Tax Court's decision must be reversed.[9/] To the contrary, we contend that this Court's statements in Borax' Estate and Wondsel should have no application on the issue raised in this case; however, to the extent the reasoning of those cases is found to be applicable, we submit that those cases are erroneous, and should not be followed in this case.

Borax' Estate and Wondsel presented, inter se, identical legal questions, on fact situations which closely paralleled one another. In Borax' Estate Herman and Ruth Borax, New York residents, had entered into a separation agreement which provided for support payments which were thereafter established in a 1946 New York consent decree. In 1952 Herman obtained a Mexican divorce from Ruth, he having personally appeared and she having been personally served in New York. Several weeks thereafter Herman married Hermine. In 1953 Ruth obtained a New York court declaration, Herman and Hermine having been personally served, that the Mexican divorce was invalid and that Ruth, rather than Hermine, was Herman's lawful wife, because Ruth had not been served and did not appear in the Mexican lawsuit. In Wondsel Harold and May, New York residents, entered into a separation agreement in 1936 which made provision for support payments, and stipulated that such terms should, at May's election, be incorporated in a

9/ The Commissioner has not acquiesced in Borax' Estate and Wondsel, not only for federal income tax purposes, but also in cases concerning "questions pertaining to the marital deductions allowed by sections 2056 and 2523 of the Internal Revenue Code of 1954." Rev. Rul. 67-442, 1967-2 Cum. Bull. 65.

subsequent divorce decree. In 1937 Harold obtained an ex parte Florida divorce which incorporated the terms of the separation agreement. Harold married Virginia in 1939, but in 1941 May obtained an uncontested judgment in the New York courts that the Florida divorce decree, as well as Harold's subsequent marriage, were nullities. In 1946 Harold and Virginia executed a separation agreement which provided for Virginia's support, and this agreement was thereafter approved in a 1946 ex parte Florida divorce which Harold obtained. Three months later Harold married Joyce, with whom he lived until 1961, when Joyce obtained an annulment of her marriage on the grounds that Harold was still married to May. The issues raised in Borax' Estate and Wondsel were two-fold: (1) were amounts paid by the husbands pursuant to the separation agreements payments made under instruments incident to a divorce, as required by Sections 71 and 215 of the 1954 Internal Revenue Code (26 U.S.C.) and predecessor statutes, so as to require inclusion of such amounts by the woman and deduction of such amounts by the man, where the succeeding divorce was thereafter declared a nullity; and (2) were the husbands entitled to file joint returns with, and claim a dependency exemption for, the succeeding wives, or their parents and children.[10/]

10/ Section 6013(a) of the 1954 Internal Revenue Code (26 U.S.C.) generally allowed "A husband and wife" to file a joint return, except that "an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married". (Sec. 6013(d)(2) of the Code.) Section 151 of the 1954 Code (26 U.S.C.) authorized a $600 exemption for

In Borax' Estate this Court first addressed the question of the deductibility from the husband's income, and includibility in the first wife's income, of amounts paid to the wife under the separation agreement. For this tax situation, three facts had to be established, as this Court recognized (349 F. 2d, p. 670):

> (1) Ruth and Herman were divorced under a decree of divorce; (2) the payments were made in discharge of a legal obligation imposed upon or incurred by Herman under such decree or under a written instrument "incident to such divorce"; and (3) the payments were periodic and received subsequent to the divorce decree.

As to the first condition, this Court ruled that (Ibid):

> We hold, for purposes of these provisions of the federal tax statute, and within the meaning of these provisions, that for the years in dispute Ruth and Herman were divorced under a decree of divorce. The subsequent declaration of invalidity by a jurisdiction other than the one that decreed the divorce is of no consequence under these provisions of the tax law. (Emphasis supplied.)

This conclusion was reached for two reasons. First, finding it inadvisable for courts in collateral tax-deficiency proceedings to attempt to decide which of several contradictory rulings regarding the validity of a particular divorce was entitled to primacy, the possibility of different States adopting different

10/ (continued)
"the spouse of the taxpayer", except that Section 153 (26 U.S.C.) provided that "An individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married". Section 152 (26 U.S.C.) also allowed a dependency exemption, for persons described in that section, such as a "stepson or stepdaughter of the taxpayer" or "father-in-law" or "mother-in-law" of the taxpayer. Sects. 151(e)(1)(A) and 152(a)(2) and (8).

positions regarding the validity of individual divorces prompted this Court to adopt a "rule of validation"--to leave "the mobile spouse with the power to obtain a divorce in a jurisdiction whose decrees might not be recognized in every other jurisdiction" yet apply the income tax consequences with evenness and certainty: "all those taxpayers who have obtained a divorce in a particular jurisdiction are treated the same, regardless of whether the spouse against whom the decree has been obtained is able to, and does, invoke the power of another jurisdiction to declare that divorce invalid". (Ibid.)[11/] Second, this Court emphasized liberalizations to Section 71 which had been enacted for later tax years which extended income tax relief "where the husband and wife are voluntarily separated and there is a written separation agreement". (Ibid.)[12/] Since this Court found that "The requirement that the marital relationship be dissolved by a judicial decree of divorce (or legal separation) as opposed to being dissolved by having the parties cease living together as husband and wife is not expressive of any significant [tax] policy" (Ibid.), the Congressional intent to

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11/ Two possible exceptions were noted: where the jurisdiction granting the divorce later declares the divorce invalid, and where the rendering jurisdiction's concept of divorce is "totally alien to that contemplated by the tax laws". (349 F. 2d, p. 672.)

12/ Section 71(a)(2) of the 1954 Code provides that "If a wife is separated from her husband and there is a written separation agreement executed after the date of the enactment of this title, the wife's gross income includes periodic payments * * * received after such agreement is executed which are made under such agreement * * *."

place the income tax burden upon the person receiving the marriage settlement payments, and to grant a tax deduction to the person making such payments, was respected.

Finally, having recognized the validity, for tax purposes, of the intervening divorce, this Court felt compelled, as a matter of tax symmetry, to recognize the validity of the succeeding marriage which had been performed in reliance upon the earlier divorce. Thus, this Court found that Herman and Hermine were "husband and wife" (contrary to the adjudication of the New York court), and that accordingly Herman was entitled to file a joint return with Hermine and claim dependency deductions for her parents and children. (349 F. 2d, pp. 675-676.)

Subsequently, this Court in Wondsel applied the holdings discussed above in Borax' Estate, where the only difference was that it was a State divorce decree which had been declared invalid, rather than the Mexican divorce which had been successfully challenged in Borax' Estate, noting, in passing, that it was uncertain that the State of Florida, the rendering State, would have been bound to recognize New York's later declaration of the Florida decree's invalidity.

As a preliminary matter, it is important to recognize that the principal holding of this Court in Borax' Estate and Wondsel--that a payment of alimony pursuant to a written separation agreement is deductible by the payor and includible in the income of the recipient, regardless of whether a court of record has expressed its opinion about their marital status--is, as

this Court itself recognized in those decisions, clearly the law under the 1954 Code revisions of Section 71's predecessor. See Section 71(a)(2) of the Code, which provides:

> (2) Written separation agreement.--If a wife is separated from her husband and there is a written separation agreement executed after the date of the enactment of this title, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such agreement is executed which are made under such agreement and because of the marital or family relationship (or which are attributable to property transferred, in trust or otherwise, under such agreement and because of such relationship). This paragraph shall not apply if the husband and wife make a single return jointly.

Consequently, since Section 2056 clearly contemplates a valid marriage at decedent's death, it would seem that if the Borax' Estate and Wondsel opinions have any continuing effect, insofar as the question raised in the instant litigation is concerned, their importance must lie in this Court's additional holding that the subsequent marriage should be recognized, for income tax purposes, so that a man and woman marrying on the strength of the divorce which is later declared a nullity should be considered "husband and wife," and allowed to file a joint return as provided in Section 6013 of the Code. This is particularly so in view of the fact that the legislative history relied upon by this Court in those decisions to show that the Congress desired "'a uniform construction' of all the provisions dealing with the determination of marital status, including those related to joint returns and 'alimony and like payments'" (Borax' Estate v. Commissioner, supra, p. 675) has a chronological unity with the

legislative history underlying the enactment of Section 2056. Cf. S. Rep. No. 1013, 80th Cong., 2d Sess., pp. 22-29 (1948-1 Cum. Bull. 285, 301-306).

First, we submit that whatever desire for uniformity in income tax matters this Court may have found in the underlying legislative history surrounding the enactment of the Revenue Act of 1948, supra, to justify its categorization of a man and woman not validly married to be "husband and wife," for income tax purposes, does not extend to estate tax issues, such as that here presented. The full legislative history explaining the enactment of the marital deduction provisions makes it quite clear that, at least in the estate tax area, Congress did in fact intend for tax consequences to be affected by the validity of marriages. Thus S. Rep. No. 1013 (Part 2), supra, pp. 6-7 (1948-1 Cum. Bull., p. 335) unequivocally announces that judicial actions which have "not (at the time of the decedent's death) terminated the marriage" have no effect on an individual's status as "surviving spouse," and transfers of property by an individual to whom the transferor "is not married * * * at the time of his death" do not satisfy the statutory prerequisite that property pass to one's "surviving spouse." It is difficult to contemplate stronger evidence that Congress intended that only transfers from individuals to whom the transferor was legally married, under the domicile of the decedent at the time of the transfer and of his death, should qualify for the marital deduction. Congress, in enacting the marital deduction

provisions, was anxious only that residents of common-law jurisdictions be afforded the same estate tax benefits which community-property jurisdictions had always allowed their residents--that property acquired during the marital relationship be attributable to each spouse to the extent of up to one half of the value of the property. Nothing in that legislative history shows any interest on Congress' part in allowing residents of common-law states who were not validly married to obtain in an estate tax setting the income-splitting benefits which were available to community-property state residents only upon the premise that they themselves were validly married.

Moreover, we respectfully submit that this Court's determination in Borax' Estate and Wondsel that, under the 1954 Code, a man and woman not validly married may satisfy the criterion that they be "husband and wife," so that they may file a joint income tax return, was motivated to a large extent by the anomaly which would follow if the intervening divorce which led them to remarry is recognized for some income tax purposes (as the court did in allowing deduction for payments under the separation agreement), but not for others, rather than any particular statement in the Code or in legislative history which would compel that result. A careful examination of the statutory provisions regarding the right of two individuals to file a joint return demonstrates that, contrary to this Court's assumptions in the Borax' Estate and Wondsel cases, the Congress viewed the alimony provisions of Sections 71 and 215 in a far different light, and with different objectives, than the joint income tax return provisions

of Section 6013. As Spolter, Invalid Divorce Decrees, 24 Tax L. Rev. 163, 187-188 (1969), notes--

> The most fundamental defect of the court's approach is that its rule is too mechanical and ignores the different policy objectives of the various Code sections. It has been indicated that the primary justification for the validation rule as applied to alimony was a liberal congressional policy, as evidenced by the 1954 amendment allowing written separation agreements to qualify. Obviously, this reasoning has nothing at all to do with joint returns and exemptions.
>
> On the other hand, there are valid reasons for differentiating between alimony payments and these other tax provisions. With alimony, sound policy calls for a liberal construction of the statute, because the marital status of the parties is only tangential. The basic issue is how to tax certain transfers of property from the husband to the wife, so the requirement of a divorce as a condition precedent to the application of sections 71 and 215 should be viewed realistically. In the case of joint returns and exemptions, however, this economic rationale is not applicable. There is no transfer of property through which a tax burden can be shifted. The benefits provided for in those sections are in the nature of a bonus given by the Code. With regard to them, marital status is the basic and decisive issue, so it is reasonable to require a strict construction of the statute and look to the substantive domestic relations law of the taxpayer's domicile.

While the splitting of income provisions were made available, in Sections 71 and 215, to married couples who settled the legal obligations of one spouse to support the other by written separation agreement as well as by judicial decree,[13] the

[13] Thus Section 71(a)(1) requires a wife to include in income periodic payments received under a decree of divorce or separate maintenance; Section 71(a)(2) requires the wife to include in

joint return provision was made available only to a "husband and wife" (Sec. 6013(a)), such term being restricted by Section 6013 (d)(2) to provide that "an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married." See S. Rep. No. 1013, supra, pp. 55-59 (1948-1 Cum. Bull., pp. 328-330). The very language of the statute establishes that while Congress considered the validity of the divorce to be irrelevant, in determining the right of the parties to split their income, the issue of whether the parties were "legally separated," under court decree, was of paramount importance in evaluating their right to file an income tax return jointly.[14/] And see Kapp, Tax Aspects of Alimony Agreements and Divorce Decrees: the Effect of Conflicting Decrees, 27 N.Y.U. Institute on Federal Taxation 1231, 1251-1252 (1969).

13/ (continued)
income periodic payments received under a written separation agreement, unless the parties file a joint income tax return and Section 71(a)(3) requires a wife to include in income periodic payments received under a support decree, unless the parties file a joint income tax return.

14/ Section 153(2) provides the same restriction in determining whether the husband may claim a personal exemption for the "spouse of the taxpayer," and Section 152(b)(5) prohibits claiming a personal exemption for "An individual (other than an individual who at any time during the taxable year, was the spouse * * *)" (Sec. 152(a)(9) of the Code) if "the relationship between such individual and the taxpayer is in violation of local law." (Section 152(a) and (b) was amended by Section 4(a) and (c) of the Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606, to include the quoted language.)

D. Extension of the Borax' Estate and Wondsell rationale to estate tax situations would result in anomalies

Finally, extension of this Court's reasoning in the Borax' Estate and Wondsel cases would produce multiple anomalies, as the facts of Estate of Steffke v. Commissioner, supra, and Estate of Goldwater v. Commissioner, supra, show. In the Steffke case Priscilla Baker Lane was, prior to June 9, 1966, the wife of Crockett Lane, the two of them being residents of, and domiciled in, the State of Wisconsin. On that date Priscilla obtained a Mexican divorce, on grounds not recognized in the State of Wisconsin, from Crockett Lane, she personally appearing and Crockett entering a general appearance through counsel. Priscilla married Wesley Steffke in 1967 in Wisconsin, and Wesley died a resident of the State of Wisconsin in 1968, leaving a will probated in the State of Wisconsin which left most of his estate to Priscilla. In 1968 a Wisconsin probate court determined the identity of Wesley's heirs-in-law for purposes of calculating the Wisconsin inheritance tax liability. Although the Wisconsin inheritance tax rates would have been lower to Priscilla if she had been Wesley's widow,15/ the State probate court ruled that she "is found not be to the legal wife and widow of the decedent" Wesley because the Mexican divorce "was

15/ Former Wis. Stat. Ann. Section 72.02(1) levied a tax of 2 percent of the value of property passing to a "husband, wife," but Wis. Stat. Ann. Section 72.02(4) levied and 8 percent tax on property transferred to a "stranger in blood to the decedent." West's Wis. Stat. Ann. (1969), §72.02. Accord, using different tax rates, with respect to transfers after May 13, 1972, to a "surviving spouse." West's Wis. Stat. Ann. (1969; Cum. Ann. Pocket Part, 1975-1976), §§72.16-72.18.

not valid and binding in the state of Wisconsin," and this was affirmed by the Wisconsin Supreme Court, which, in Estate of Steffke, 65 Wis. 2d 199, 207, 222 N.W. 2d 628, 633 (1974), ruled: "The Mexican divorce granted to Priscilla Lane in 1966 is of no effect in the State of Wisconsin. She was not the wife of Wesley Steffke under the laws of the State of Wisconsin * * *." (64 T.C., pp. 531, 532.) Were this Court's analysis in Borax' Estate and Wondsel to prevail in this case, then a woman who was not the decedent's surviving spouse for State estate tax purposes would contradictorily be entitled to that status for federal estate tax purposes. Indeed, as the Tax Court in the Steffke case noted (in disallowing the marital deduction for property passing to Priscilla), this same anomalous situation could arise in a multitude of situations, such as, for example, a case where a State had declared an individual not to be entitled to dower, for failure to demonstrate a valid marriage; or where a State had declared that an individual was not entitled to take part of a decedent's estate under the intestacy laws, for failure to establish that such individual was validly married to the decedent at his, or her, death.[16] Estate of Steffke v. Commissioner, supra, p. 538.

Another potential anomaly is demonstrated by the case of Estate of Goldwater v. Commissioner, supra, pending on appeal

16/ Other examples given by the Tax Court in Steffke include State determinations of an individual's right to claim a support allowance under State law, or to qualify for homestead rights. Estate of Steffke v. Commissioner, supra, p. 538.

(C.A. 2, No. 75-4277). There Leo Goldwater and Gertrude Goldwater, residents of and domiciled in the State of New York, were married in New York in 1946. In 1955 Gertrude obtained a final decree of separation from Leo in the New York courts. On March 20, 1958, Leo obtained a Mexican divorce from Gertrude, he personally appearing and she being served in New York. Gertrude instituted a declaratory judgment action against Leo in the New York courts on October 16, 1958, seeking, among other things, a declaration that the Mexican divorce was invalid. The New York court ruled, under circumstances where Leo personally appeared, admitted the invalidity of the Mexican divorce, and refused to oppose this request for relief, that the Mexican divorce was invalid, that Gertrude was Leo's lawful wife since 1946, and that Lee Jablow, who married Leo in Connecticut on December 9, 1958, was not and never had been Leo's wife. Leo died a resident of the State of New York on February 21, 1968, bequeathing fifty percent of his estate to Lee, but Gertrude filed a notice of her election to take an elective share of Leo's estate, pursuant §5.1-1, Estates, Powers and Trusts Law, McKinney's Consol. Laws of N.Y. Ann., which she was allowed. Leo's estate claimed a marital deduction, under Section 2056 of the Code, both for the amounts passing to Lee and the amount paid to Gertrude under the settlement compromise. The Tax Court in Goldwater allowed a marital deduction only for amounts passing to Gertrude. While there was a certain equity in this Court's allowing the parties in Borax' Estate and Wondsel to recognize, for income tax purposes,

the alimony arrangements which the parties had arrived at, it would surely be anomalous to permit the estate to claim a marital deduction for amounts passing to the second spouse, while the laws of the decedent's domicile have required the estate to pay a portion of the decedent's assets to the first wife, as his sole "surviving spouse." Acceptance of taxpayer's rationale could result in further unwarranted tax avoidance, since estates in this situation could argue that, for federal estate tax purposes, the decedent had two "surviving spouses."

Indeed, application of the Borax' Estate and Wondsel rationales to Section 2056 questions may, in the end, prove deleterious to estates, since the protections afforded by particular states to women who have been divorced under procedures not recognized as valid may provide such an individual with the substantial portion of an estate, despite testamentary attempts to bequeath the estate to the second "spouse." Under these circumstances, if the Borax' Estate and Wondsel analysis were to prevail, the estate would receive a substantially reduced marital deduction, and incur a consequently larger estate tax, since only amounts passing to the decedent's "spouse," i.e., the individual to whom the decedent was married, would qualify for the marital deduction. And, although the Steffke and Goldwater cases and this case all arise in a similar factual setting, where there had been a remarriage, the fact should not be lost that the same legal question can arise where no remarriage occurs. That is, suppose that the husband obtains a foreign

divorce which the courts of the parties' domicile later declare invalid. Upon the husband's death, any number of factual possibilities present themselves: the "wife" is bequeathed all of the estate; the "wife" is bequeathed nothing, but claims a dower interest, a homestead right, or a right of election to take against the husband's will; or, perhaps, the husband dies intestate, and the "wife" claims an intestate share as his widow. Under this Court's ruling in Borax' Estate and Wondsel, it would appear that because the jurisdiction rendering the divorce might not have to recognize the decrees invalidating the divorce,[17/] the "rule of validation" would compel the conclusion that, for federal estate tax purposes, the husband died without a "surviving spouse", although distribution of assets are made to her. As Spolter asserts (Spolter, Invalid Divorce Decrees, supra, p. 187)--

> Where, for example, property rights depend on marital status, the Borax court would have to concede that the law of the taxpayer's domicile controls. There is simply no other basis on which to determine, for tax purposes, what property interests have been created. To illustrate: If a husband dies without a will after having secured an invalid foreign divorce, local law will generally allow the wife to inherit at least part of the estate as a spouse through intestate succession,

17/ See Colby v. Colby, supra; cf. Sutton v. Leib, 342 U.S. 402 (1952). Considering the fact that Charles deposed in the New York suit that his residence had always been in New York at the time when he was initiating the Nevada divorce proceeding, it would seem that even the courts of the State of Nevada would have had no hesitancy in declaring their prior divorce decree to be a nullity because of the extrinsic fraud committed upon the court when Charles falsely claimed that he had satisfied the jurisdictional prerequisite under Nevada law that he was a Nevada resident at the time he commenced divorce proceedings. See Colby v. Colby, supra; Nev. Rev. Stat. §125.020(2).

> despite the divorce. Under these circumstances, would Borax preclude a marital deduction for estate tax purposes on the ground that, since the divorce is given tax recognition and treated as valid, the wife should have inherited nothing as far as federal tax law is concerned? This would be an absurd result indeed. It is clear that local law must prevail where property interests are in issue, even if a collateral determination of marital status is also involved.

Consequently, it seems clear that the "uniform" tax consequences urged (see Appellant's Br. 8) by the taxpayers in these cases is largely a mirage built upon the misapplication of the uniformity which this Court found to be the Congressional will, in an income tax setting. In the context of the federal estate tax, it is probably impossible to reach an equitable rule which will unquestionably comply with all jurisdictions' attitudes toward the validity of a particular marital state. The rule expounded by the Commissioner in Rev. Rul. 64-477, 1967-2 Cum. Bull. 65, supra, that generally the law of the decedent's domicile towards the validity of the marriage will prevail, is a sound and expedient solution to the many factual variations which may occur, and should be affirmed by this Court. As the Seventh Circuit in a similar situation ruled, the Congressional attempt "to eliminate problematical uncertainties and inequities resulting from variances in the laws of the different states concerning the existence of an obligation to pay alimony" must of necessity be controlled by the plain language of the statute that there be a "legal obligation" to pay alimony, under state law, before the

provisions of Section 71 of the Code applied to tax payments to the divorced taxpayer. Hoffman v. Commissioner, 455 F. 2d 161, 162 (C.A. 7, 1972), aff'g per curiam 54 T.C. 1607 (1970).

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted,

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FEBRUARY, 1976.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 12th day of February, 1976, in an envelope, with postage prepaid, properly addressed to them as follows:

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) Allowance of Marital Deduction.--For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * *

H. Rep. No. 1274, 80th Cong., 2d Sess., pp. 3, 4, 21, 24-26 (1948-1 Cum. Bull. 241, 242, 243, 257, 260-261):

II. SUMMARY OF CHANGES IN EXISTING LAW.

H.R. 4970 is both a tax-reduction and tax-equalization bill. The tax-reduction features apply solely to the individual income tax. They include a general increase in exemptions, a reduction in all tax rates but with the relief concentrated in the lower income brackets, and special exemptions for those over 65 and the blind. The tax-equalization features of the bill apply to the individual income tax and the estate and gift taxes. They, combined with an amendment which your committee intends to offer on the floor of the House, are designed to produce uniform treatment for residents of common-law and community-property States.

A comparison of the effective individual income-tax rates under the bill with those under present law is shown in table I. The changes in the rates and exemptions of the individual income tax under this bill are effective January 1, 1948. The withholding tables will become effective on April 1, 1948. Overwithholding during the first three months of 1948, which is not offset by decreased payments on estimated taxes or final returns, will of course be refunded to the taxpayer. The changes in the estate and gift tax become law on the date of enactment of this bill. A brief description of the changes provided by your committee's bill is given below.

* * *

B. Estate and Gift Taxes

1. The 1942 amendments to the estate and gift tax which provided special rules for community-property States are repealed for persons dying after the enactment of this bill. Generally, this restores the rule by which estate and gift-tax liabilities are dependent upon the ownership of the property under State law. Thus, in community-property States, irrespective of which spouse dies first, only one-half of the community property is included in the gross estate. Similarly, one-half of a gift made out of community property is taxable to the husband and one-half to the wife, since under State law each owns a one-half interest in the property.

2. A committee amendment will be offered on the floor of the House to provide for estate and gift-tax "splitting" in common-law States. This amendment also will apply to persons dying after the enactment of this bill, so that both the community-property States and the common-law States may be placed on an equal basis at the same time. Thus, in these States property passing from a decedent to his spouse is excluded from the decedent's estate-tax base up to a limit of 50 percent of the value of his estate. In a similar fashion husbands and wives may treat gifts made currently as being made one-half by each spouse. Residents of community-property States may also take advantage of this provision. If they do so, the effect will be to extend this "splitting" to their separate property. The repeal of the 1942 amendments already gives them the right to split community property. In effect, these amendments represent the adoption of a new national system for ascertaining Federal estate- and gift-tax liability. The adoption of these amendments will extend substantial benefits to residents of both community-property and common law States. The delay in the preparation of this amendment is due to the inherent difficulties of the subject.

*　　　*　　　*

VIII. EQUALIZATION OF TAX BURDENS OF RESIDENTS OF COMMUNITY PROPERTY AND COMMON LAW STATES.

*　　　*　　　*

B. The Estate and Gift Taxes.

The basic differences between community and common law interpretations of property rights have also resulted in geographical inequalities in the application of the

estate and gift taxes. Prior to 1942 the taxation of transfers made by married persons depended upon the property law of the State in which the transfer took place. In community-property States only half of the community property belonged to one spouse. Hence only half could pass at his death, and only half could be subjected to the estate tax. Similarly, gifts out of community assets were regarded as one-half the gift of the husband and one-half the gift of the wife. No similar division of assets occurred under common law because, in most cases, practically all the property was the husband's under State law. Since both estate and gift taxes have sharply progressive rates and are equipped with large exemptions, the consequence was a substantially lower tax on transfers in community-property States than on transfers of similar size in common-law States.

In 1942 the Congress attempted to produce more nearly equal results. Amendments were passed which provided that in community-property States the entire community property was to be treated as the estate of the first spouse to die, except such portion as could be shown to have been received "as compensation for personal services actually rendered" by the surviving spouse, or derived originally from such compensation, or from the separate property of the surviving spouse. The application of this rule in community-property States was subject to the limitation that the estate of the first of the spouses to die was never to be less than the value of the property over which that spouse had a testamentary power of disposition. This meant that the estate of the spouse who died first could never be less than one-half of the community property.

The Revenue Act of 1942 made a similar amendment in the gift tax. Henceforth all gifts out of community property were to be taxed as though they had been made by the husband, unless it could be established that the assets transferred had been received by the wife as "compensation for personal services actually rendered" or derived from her separate property.

Unfortunately, the 1942 amendments did not produce complete geographical equalization. Cases exist in which transfers of community property are taxed more heavily than transfers under common law. Conversely, there are instances in which transfers in the common-law States are taxed more heavily.

A case in point occurs when the husband dies first, leaving his entire estate to his wife, who in turn on her death leaves her entire estate to a child. Under common law the husband can give his wife a life estate in the property, providing in his will that upon her death the assets go to the child. Here an estate tax would be due upon the death of the husband, but there would be no tax upon the death of the wife. Under community property the husband can place only his half of the community property in a similar life estate for the benefit of his wife. Thus, in the community-property State the whole estate would be subject to tax upon the husband's death, just as in the common-law State, but at the death of the wife there would be an additional tax upon her share of the community property. 18/

Another example is provided by the case in which a wife dies first, leaving her rights in the community assets to her husband, who in turn leaves the entire community to a surviving child. Under the 1942 amendments there would be a tax on one-half the community at the time of the wife's death, and a tax on the entire community at the death of the husband. 18/ Under similar circumstances in a common-law State there is apt to be little or no tax due at the death of the wife, since most of the family assets will be the husband's property.

A case in which the transfer in the common-law State is taxed more harshly occurs when the wife dies first, and most of the property belongs to the husband. Under common law there would be no tax due on the wife's death and the entire property would be taxable at the death of the husband. If these same assets were community property, one-half would be taxable at the death of the wife and the other at the death of the husband. Because the rates applied are progressive and the exemption substantial, the result is a larger aggregate tax in the common-law States than in community property jurisdictions.

Exception also has been taken to the so-called "tracing problem." This arises under the 1942 amendments because of the need for identifying the portions of the community contributed by each spouse. Establishing the fact that particular assets derived from "compensation for personal services actually rendered by the survivor"

18/ The assumption is made here that the wife's death occurred more than five years after the death of the husband.

is particularly difficult. Moreover, the precise interpretation of "compensation" which the Bureau of Internal Revenue will apply in a given situation is by no means clear. Under the 1942 amendment this tracing problem is of far larger dimensions in community-property States than in common-law jurisdictions, where it is limited primarily to joint tenancies, tenancies by the entirety, and joint bank accounts.

Your committee does not believe that a satisfactory solution to the problem of geographical equalization can be reached by the tactics applied in the 1942 amendments. Hence the repeal of these amendments is recommended, effective with the enactment of this bill. Your committee would be unwilling, however, to repeal the amendments without corrective legislation. Repeal alone would reproduce the pre-1942 conditions which are even further from equalization than existing law.

With the repeal of the 1942 amendments your committee recommends an application of the "splitting" technique used under the income tax. This provision is not contained in the bill which is being reported, but will be covered by a floor amendment. In the case of the estate tax, "splitting" means an exemption in common-law States of up to one-half of the decedent's estate if it passes outright to the surviving spouse. No such exemption is needed for community property since, in the absence of the 1942 amendments, the decedent will be taxable on only one-half the community assets. However, the exemption will apply in community-property States to separate property of the decedent which passes to his surviving spouse.

This "splitting" technique is also applied under the gift tax. In the case of gifts between spouses (other than the donor's interest in community property) this technique requires that only one-half the value of the gift be taxed since under the "splitting" technique the donee spouse in effect already owned one-half of the property. When a gift is made to some one other than a spouse, the husband and wife may elect to have the gift treated as though each had made one-half of the gift.

The amendments to the estate and gift taxes contained in H. R. 4790 (including the committee amendment) will produce approximate geographical equality in these taxes just as the income-splitting amendment will in the case of the income tax.

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S. Rep. No. 1013, 80th Cong., 2d Sess., pp. 3, 5, 22, 26-28 (1948-1 Cum. Bull. 285, 286, 288, 301, 303-305):

II. SUMMARY OF CHANGES IN EXISTING LAW.

*   *   *

B. Estate and Gift Taxes.

1. The 1942 amendments to the estate and gift taxes which provided special rules in the case of community property are repealed for persons dying and as to gifts made after the date of the enactment of this bill. Generally, this restores the rule by which estate- and gift-tax liabilities are dependent upon the ownership of the property under State law. Thus, in community-property States, irrespective of which spouse dies first, only one-half of the community property is included in the gross estate. Similarly, a gift made out of community property is taxable one-half to the husband and one-half to the wife, since under State law each owns a one-half interest in the property.

2. Provision is made for estate and gift tax "splitting" of noncommunity property. This provision also will apply to persons dying after the date of the enactment of this bill, so that community property and noncommunity property may be placed on an equal basis at the same time. Under this provision property passing outright in a common-law State from a decedent to the surviving spouse is deducted from the decedent's gross estate up to a limit of 50 percent of the value of the decedent's gross estate less deductions for funeral expenses, debts, and other claims against the estate. In a similar fashion husbands and wives, in common-law States, may treat their gifts as being made one-half by each spouse. Residents of community-property States may also take advantage of the estate and gift tax splitting provisions with respect to transfers of their separate property. The same splitting effect is achieved for community property by the repeal of the 1942 amendments.

*   *   *

VIII. EQUALIZATION OF TAX BURDENS OF RESIDENTS OF COMMUNITY-PROPERTY AND COMMON-LAW STATES.

* * *

B. The Estate and Gift Taxes.

The basic differences between property rights in community-property and noncommunity-property States have also resulted in geographical inequalities in the effect of the estate and gift taxes. In community-property States husbands and wives have an undivided one-half interest in the community property. Prior to 1942, upon the death of a spouse his one-half interest in the community property, over which he had the power of testamentary disposition, was subject to the estate tax. Similarly, a gift of community property was taxable as though one-half of the value was the gift of the husband and one-half the gift of the wife. On the other hand, in common-law States neither spouse had an undivided interest in the property of the other spouse. Since both estate and gift taxes have sharply progressive rates, with large specific exemptions, the consequence was a substantially lower tax on transfers in community-property States than on transfers of similar size in common-law States, where the usual case was that practically all the wealth of the married couple was the property of the husband.

In 1942 the Congress attempted to provide more nearly equal results under the estate and gift taxes. The estate tax amendments of that year provide that the entire community property be included in the decedent's gross estate, except such portion as can be "shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse." Under this rule, the entire community property is taxable to the first spouse to die unless some portion of the community is economically attributable to the survivor. However, the 1942 amendments further provide that regardless of which spouse was responsible for the acquisition of the community, at least one-half of the value of the community is includible in the decedent's gross estate. The basis for this rule is the fact that rights to at lease one-half the community are transferred on the death of either spouse. The rule is necessary since the share of the spouse dying first may not be transferred to the surviving spouse and the community assets may not be economically attributable to the decedent spouse. In such a case, if no tax were imposed, the property would avoid the estate tax for one generation.

S. Rep. No. 1013 (Part 2), 80th Cong., 2d Sess., pp. 6-7 (1948-1 Cum. Bull. 331, 335):

> The status of an individual as the decedent's surviving spouse is determined at the time of the decedent's death. A legal separation which has not (at the time of the decedent's death) terminated the marriage does not affect such status for the purposes of section 812(e)(1). A transfer by the decedent during his lifetime to an individual to whom he was not married at the time of the transfer but to whom he is married at the time of his death and who survives him is a transfer by the decedent to his surviving spouse. If an interest in property passes from the decedent to a person who was his spouse but is not married to him at the time of his death, the interest is not considered as passing to the decedent's surviving spouse even though such erson survives the decedent.

* * *

contributed by each spouse. Establishing the fact that particular assets of the community are derived from "compensation for personal services actually rendered by the survivor * * *," is impossible in a great many situations. Under the 1942 amendments this tracing problem is of far larger dimensions in community-property States than in common-law jurisdictions, where it is limited primarily to joint tenancies, tenancies by the entirety, and joint bank accounts.

Your committee does not believe that a satisfactory solution to the problem of geographical equalization or the difficulties of tracing can be found under the 1942 amendments or amendments using a similar theoretical approach. Hence the repeal of these amendments is recommended, effective with respect to gifts made after the date of enactment of this bill and with respect to the estates of decedents dying after the date of such enactment. Your committee would be unwilling, however, merely to repeal the 1942 amendments. Repeal alone would reproduce the pre-1942 results, which are even further from equalization than existing law.

With the repeal of the 1942 amendments your committee recommends estate and gift tax splitting which is similar in its effects to the splitting of the income tax provided for in this bill. It is recognized that complete equalization of the estate and gift taxes can not be achieved because of the inherent differences between community property and noncommunity property. However, the new provisions will result in equality in the important situations.

Under the estate-tax provision of your committee's bill a decedent spouse is allowed a marital deduction from his gross estate in the amount of the value of all interests in property passing outright from the decedent to the surviving spouse by way of bequest, devise, transfer, right of survivorship in jointly held property, etc. The deduction is limited to an amount not in excess of 50 per cent of the adjusted gross estate. 10/

* * *

10/ The adjusted gross estate is determined by subtracting from the gross estate the debts and charges provided for in section 812(b) of the Internal Revenue Code.

Similarly the Revenue Act of 1942 amended the gift tax with respect to community property. All gifts of community property were made taxable to the husband, unless it could be established that the property transferred was economically attributable to the other spouse.

Unfortunately, a number of problems have arisen under the 1942 amendments. Most important of these is the fact that geographical equalization has not been realized in a typical situation. Furthermore, the problem of determining the economic contribution of the surviving spouse to the community has resulted in an extremely difficult problem of "tracing." Severe hardship also results where, because the entire community property is includible in his gross estate, the estate tax of the decedent is larger than the community property subject to his power of disposition. For example, if a decedent is economically responsible for the entire community this average tax rate on his estate may exceed 50 per cent. However, only half of the community is subject to his power of disposition. Thus the share of the community already belonging to his spouse may be required to bear part of the tax although the spouse does not inherit any property under State law.

The most obvious instance of the failure to attain equalization results from the widespread use of life tenancies in the common-law States. In this situation, the husband transfers or bequeaths to his wife a life estate, with remainder over to the children. At his death the whole of the estate is taxed, but at the wife's death there is no tax on the cessation of her life estate. On the other hand, in a community-property State, the husband may not by his will dispose of his wife's interest in community property. If he bequeaths his one-half interest in the community to his wife for life with remainder over to the children, the entire community may be included in his gross estate, and on the death of the wife, 9/ one-half the community is also included in her estate. Thus the common-law couple is subject only to a single transfer tax, whereas the community-property couple pays two transfer taxes, one on an estate of equal size and one on an estate of half the size of that passing in the common-law State.

The "tracing problem" arises under the 1942 amendments because of the need for identifying portions of the community

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9/ Assuming that the deduction for property previously taxed is not applicable.

UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

February 12, 1976

Address Reply to the Division Indicated and Refer to Initials and Number

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5-13389

A. Daniel Fusaro, Esquire
Clerk, U.S. Court of Appeals
for the Second Circuit
Room 1702, U.S. Courthouse
Foley Square
New York, New York 10007

Re: Estate of Amy Ann McGinnis Spalding, Deceased, Charles F. Spalding, Executor v. Commissioner (C.A. 2 - No. 75-4248)

Dear Mr. Fusaro:

We are transmitting herewith for filing with your Court twenty-five copies of the brief on behalf of the Appellee in the above-entitled case.

We are forwarding four additional copies to counsel for the Appellant, together with a copy of this letter.

Sincerely yours,

SCOTT P. CRAMPTON
Assistant Attorney General
Tax Division

By: Gilbert E. Andrews/[illegible]
GILBERT E. ANDREWS
Chief, Appellate Section

Enclosures

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